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Economic Conditions
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General Business Conditions

THE optimists have had a little the better of it in the returns from business during the past month. Trade and industrial activity have made further slight advances, extending the October rise, and business sentiment likewise has improved. To be sure, the gains are moderate, and both current policies and expectations for the Winter months continue conservative. However, the improvement shows that the pessimistic opinions as to the Fall and Winter outlook, which were widely entertained at the beginning of the season, were unnecessarily extreme. These opinions placed emphasis on the obstacles in the way of improvement, and of course that is where the emphasis belongs if the depression is to be overcome. But business has shown powers of recuperation despite the handicaps. Retail sales have been larger than a year ago, and although the general tendency is to keep stocks down demand for goods has been sufficient to bring a rise in production, exceeding the seasonal expectation.

The steel industry has contributed to the rise, with operations increased to 28 per cent of capacity from the low point of 18 in September, and the steel situation illustrates the general reason for the improvement. During the Spring rise forward buying was heavy, production outran consumption, and stocks accumulated. The subsequent decline was in the nature of a breathing space to permit the absorption of these stocks, and in turn reduced production below consumption, which has been helped by public works contracts. The upturn has followed as stocks have been worked off.

Wool manufacturing is another industry contributing to the upturn, with a striking reversal of trend. The wool mills had a bad time from early Spring on, with operations declining until consumption of raw wool in September, the strike month, was only 14,600,000 pounds, probably the lowest in this century. However, the situation between the mills and the consumer was slowly mending, and when the slump reached its climax in general price cutting at the end of October the volume of business uncovered was substantial. Many mills now have orders for their output well beyond the first of the year, and prices have been marked up again without stopping the buying movement. This is the best position, with respect to Spring orders, that the industry has been in at this time in several years, and it will give correspondingly better support to business during the months to come.

These illustrations show the character of the current improvement. The decline in industrial production from the first of May through the month of September reduced the supply of goods coming on the market. Meanwhile retail trade was supported, particularly after the middle of August, by the seasonal increase in farm income, and by the purchasing power supplied through enlarged Government expenditures. Thus stocks of goods between producer and consumer have gradually been reduced to the point where increased production is demanded.

Gains in Retail Trade

Sales by department stores in seventy cities during the first half of November, reported to the National Retail Dry Goods Association, were 9.8 per cent above last year in dollars, and 9 per cent in units. This is better than the October gain shown by the Federal Reserve Board's report, which was 7 per cent, allowing for the fact that the month this year had one more selling day. Chain store and mail order sales in October were 14.1 per cent better, which compares with gains of 11.5 in September and 9.4 in August. Prices now average almost exactly the same as one year ago, according to the Fairchild index, hence the increase in dollar sales represents an equivalent increase in volume also.

Automobile sales, like those of general merchandise, have held at satisfactory levels, considering the season. The usual price reductions on old models, preceding introduction of the new, have facilitated the disposal of

dealers' stocks. Thus far the industry has given support to the upturn in industrial production only through its advance orders for materials, its own output having dropped to the lowest level of the year. During December, however, assemblies of new models will gather way.

The market for cotton goods has improved since the strike, but the position of this industry occasions some disappointment. Production made a good recovery during October, advancing to approximately the Spring peak, and sales during the forepart of the month had a good spurt. However, the mills have goods on hand, and the statistical position hardly supports the production rate reached. Hence operations have eased slightly, and further curtailment is talked of. Silks and rayon have experienced a good demand.

In general, the situation shows that the chief industries have passed through the resting period and entered the upturn, or will soon do so. The prospect is that Christmas trade will be satisfactory, and will further assist the clearance of old merchandise stocks, some of which have been carried over from 1933.

There is considerable testimony to the effect that the gains in retail trade have not come easily. Along the Eastern seaboard particularly the gains have been concentrated in the stores making strong sales efforts, based on price appeal. This is but one of the many indications of low purchasing power which keeps business men in a conservative frame of mind, but it prompts the observation that there is no way to improve trade except by making prices to fit the consumer's pocketbook, and no way to bring lasting progress out of the depression except by general cooperation to that end.

The chief question as to the quality or lasting character of the retail improvement arises from the degree in which it depends upon purchasing power supplied by the Federal Treasury, through the relief payments and other emergency expenditures. These disbursements are well above last year's figures and their relationship to the retail expansion is apparent to all merchants, especially in the farm areas; they are only a minor part, to be sure, in the total buying power available for retail purchases, but they are large enough to represent the difference between good and bad trade.

Far more than in the early stages of the program, business men are looking beyond the immediate effects of these disbursements, and are finding in the dependence of trade upon them, even at its current low levels, a reason for continuing conservatism. The situation is evidence that the economic system is still far short of running under its own power; and until the system can support itself in the accustomed manner, through the production and exchange of goods among its members, there will be a question as to the ability to support it indefinitely by supplying purchasing power derived from outside the circle of production and exchange.

Factors in the Outlook

The outlook for the first quarter of 1935 is now becoming of chief interest to business men, and from the description already given some of the factors that will influence the trend are apparent. That the Treasury disbursements will continue to supply purchasing power is reasonably certain, since the unemployment will call for relief and the payments to agriculture will be heavy. It is estimated by the A.A.A. that $283,000,000 of the rental and benefit payments thus far authorized will remain to be disbursed after January 1. This is half as great as the total already paid and to be paid during 1934, and it takes no account of the new cotton, corn-hog, or other 1935 programs. It likewise appears that industrial production on the whole is well adjusted to the markets, and that the inventory situation, as a rule, will not stand in the way of improvement, if purchasing power is maintained.

Moreover, there have been developments tending to help the economic system to recover its self-supporting character, which have had a heartening effect. No demonstration is necessary to show that one of the factors in the disturbance of the system is the reluctance of capital to seek investment, which is an element in the backwardness of the capital goods industries, the chief area of unemployment. The capital markets have had encouragement during the month from the action of the Treasury in terminating the controls on purchases of foreign exchange. This is chiefly significant as an indication that no further devaluation of the dollar is at present contemplated. The purpose of the controls, which in practice were chiefly matters of form, was to prevent a flight of capital from the country during the revaluation process; and another change in the gold content would be so inconsistent with their removal that the action is taken as public notice of the intention to keep the dollar stable.

Also, the new measures designed to induce a flow of capital into the field of residential construction may prove important in promoting the revival of that distressed industry. The building figures continue extremely backward. Total contracts awarded in the 37 Eastern States, according to the Dodge compilation, averaged 11.1 per cent less during the first half of November than in October, a more than seasonal decline, and were 31.5 per cent less than in November a year ago, when public works awards were large. The importance of building in the economic life of the

country is such that a well balanced recovery is hardly to be expected as long as it continues depressed. We give a discussion of these measures in a subsequent article in this Letter.

In the area of price and wage relationships the tendency of the overhead authorities to avoid further disturbance of wage scales and hours of labor, and to encourage price reductions, seems clearly marked. The "freezing" of labor costs would leave little latitude for early reductions in prices of finished goods which experience indicates are desirable to increase sales, production and employment. It would add to the inflexibility of business, and constitute an obstacle to adjustments that are obviously needed in some lines. However, stability in wage rates would be a gain, and reduction of costs at every wage level, through the resources of management, plant improvement and technical progress, is unceasing in the business world. Indeed it is the source of all the progress that has been made, including the gains of labor.

It is probable that the average business man would welcome nothing more heartily at this time, and that nothing would be more beneficial in the situation, than a respite from changes in labor cost levels and labor policies, coupled with convincing assurance that the value of the dollar would not be altered, either by intent or by pushing fiscal policies to dangerous extremes. Given such conditions, the constant effort of millions of individuals in the economic system to make the adjustments necessary to improve business would have an effect far more stimulating than is now possible, in view of the incalculable nature of the chief influences in the economic situation.

Finally, it is notable that business men, in their calculations for 1935 are giving little weight to the much discussed possibility of "inflation," using the term to denote expanding credit and actively rising prices. Either of two conditions might lead to the use of the latent powers of credit expansion, with stimulating effects on prices. One is the establishment of economic relations in such sound balance that trade will expand without artificial aids, profits increase, new enterprises be facilitated, and assured rewards held out for the exercise of business initiative. The other is the development of a general fear of the money, leading to its exchange for property and commodities. It cannot be said that the first condition yet prevails, but happily the second appears to be remote.

World Gold Movements

World gold movements continue to reflect the nervous state of the world money markets and the extent to which capital movements have come to monopolize exchange transactions, ordinarily dominated by routine commercial and financial transactions. Within the past month new scares on the Continent developing out of the assassination of King Alexander in October, the Cabinet crises in France and Belgium, and the constant threats against the gold bloc exchange parities, have resulted in a new movement of funds across the Channel and the Atlantic, carrying sterling up to 76.12 francs early in the month and leading to the engagement of $140,000,000 in gold in France, Holland and Belgium for shipment to New York. When it is considered that less than three months ago sterling was selling at a record low of 73.70 francs, gold was moving from New York to Paris, and much uneasiness was being felt with respect to the position of the pound and the dollar, the extreme sensitiveness of the exchange market and liability of exchange movements to abrupt reversals of trend with every passing rumor are clearly emphasized.

U. S. Gold Stocks at New Peak

The gold imports during the past month raised total monetary stocks of the United States to a new peak of $8,076,000,000 on November 21. Valued in terms of old dollars this would be $4,770,000,000, compared with the previous peak of $5,015,000,000 reached in September, 1931, just prior to the suspension of gold payments by Great Britain, which threw the world into a panic and resulted in so great a withdrawal of foreign balances from the United States as to reduce our gold stocks by over $1,000,000,000 during the succeeding nine months. If consideration is given, however, to the fact that the reported gold stocks for 1931 included about $370,000,000 of gold estimated then to have been in circulation but since dropped out of the figures as irretrievably lost, it would appear that the present gold stocks, even at the old valuation of $20.67 per ounce, are the highest ever reached in the history of the country.

Mal-distribution of Gold Increased

Evidently no progress is being made in effecting a redistribution of the America's excessive gold holdings, in spite of general recognition of the fact that some correction of the existing mal-distribution of gold would be in the interest of world recovery. It will be recalled that President Roosevelt, in his message to Congress last Winter in presenting the monetary act for revaluing the dollar, indicated acceptance of the view that a maldistribution of gold existed at that time, for he referred to the possibility that this country might be required to participate in "a future agreement among nations for a redistribution of the world's monetary gold." Nevertheless, since then, our stock of gold has been increased by something like a billion dollars, owing largely to the return early in the year of

American capital from abroad, and inflow of foreign capital, hoping to participate in the rising prices expected to result from the Government's monetary program.

It has been argued on behalf of the program of the United States Government purchases of silver in world markets that such purchases would be a means of bringing about some of the desired redistribution of American gold stocks. Initial purchases under this program were, in fact, instrumental in causing some loss of gold from this country in August and early September. However, it was soon found that these purchases had such a disturbing effect upon the Far Eastern exchanges that they had to be decidedly curtailed. This reduction in U. S. silver buying, coinciding with an outflow of funds from the gold bloc countries, has brought about the resumption of American gold imports.

Incidentally, the $140,000,000 of gold engaged during the past month has complicated the Treasury's problem of building up silver stocks to the 25-75 ratio with gold called for by the Silver Purchase Act of last Summer. According to a recent announcement by the Treasury, silver stocks acquired since the enactment of the purchase law to November 13 amounted to 200,000,000 ounces, but the Government still holds less than half the huge total of more than 2,000,000,000 ounces needed to fulfill the requirements of that law. With every dollar that the monetary gold stocks are increased through gold imports, the amount of silver that will have to be purchased in order to establish the 25-75 ratio is, of course, also increased.

Increased Demand for Gold for International Payments

Great mass movements of gold, such as have been common since the great upheaval of the world war and as have been exemplified by the return of over $1,000,000,000 of gold to the United States since the beginning of the current year, are evidence of the extent to which gold has departed from its usual function in international payments. Ordinarily gold is used merely as a medium of settling temporary differences in the balances accruing to and from the various countries, and the amount of gold shipped has usually been only a small percentage of the total volume of international settlements taking place. How far the world has departed from this customary usage of gold is revealed by the fact that this metal now constitutes one of the principal items in the balance of payments. In the case of the United States, for example, gold imports valued at $960,000,000 during the first nine months of this year were equal to 79 per cent of the total value of all imports of merchandise during the same period.

While figures are not readily available which would show the total volume of gold imported and exported by all the principal trading nations, statistics published by the Federal Reserve Bulletin showing the net surplus of exports and imports of gold for different countries will suggest the extent to which gold has come to figure in international exchange movements. Following are the data for seven countries for 1933 complete, and for 1934 from the beginning of the year to as nearly up to date as possible:

Gold Movements, Net Surplus of Imports or Exports
(000,000 omitted)

	1933 (Old $)	1934 (New $)
United States	+173	+921 (10 mos.)
United Kingdom	+677	+634 (10 ")
France	+244	—396 (9 ")
Germany	—103	—103 (9 ")
Netherlands	— 67	— 94 (9 ")
Switzerland	— 41	— 69 (9 ")
India	—126	—172 (9 ")

It is apparent that these huge shifts of gold have comparatively little to do with the volume of ordinary commercial business passing between countries. For the most part they represent idle capital moving from one center to another in response to every alarmist rumor regarding political and economic conditions. These large floating balances are both a cause and an effect of the general feeling of insecurity that pervades long-term investment markets and is hampering trade revival everywhere. Constituting, as they do, a menace to the stability of monetary conditions and of currencies, it is evident that they tend to intensify uncertainty and so to act as a brake upon the utilization of capital and expansion of enterprise. At the same time it must be recognized that these huge accumulations of short-term funds are themselves the result of fear, and that only through a revival of confidence, leading to an absorption of capital in long-term investments, can they be reduced to more normal proportions.

All of which illustrates the urgent necessity of seeking stabilization of currencies at the earliest practicable moment as a means of removing one of the most potent sources of distrust, to say nothing of the actual inconvenience to trade resulting from constantly shifting exchange rates. The action of the United States Government within the past month in removing all restrictions on foreign exchange dealings and permitting free transfer of credits abroad is to be regarded with satisfaction as a step in the direction of general currency stability.

Gold Bloc Currencies Backed With Big Gold Reserves

Notwithstanding the foregoing huge shifts of gold, including the heavy return movement to the United States, the majority of European

central banks still on a free gold basis continue to hold gold reserves far in excess of the legal requirements. Both France and Poland have gold holdings larger than a year ago. In the case of the Bank of France, gold reserves of 82,070,000,000 francs on November 16 exceeded the entire outstanding note issue and were 80.7 per cent of all sight liabilities, compared with legal reserve requirements of 35 per cent. The Swiss National Bank on Nov. 7 held gold equal to 141 per cent of notes and 96 per cent of notes and deposits combined, while the Dutch and Belgian central banks likewise show a gold coverage much above the legal minimum, as indicated by the following table. Both the Polish and Italian central banks show a lower percentage of gold cover, with gold holdings of the Italian bank only slightly in excess of the legal minimum. In the case of Italy, however, gold payments are on a restricted basis, as all movements in exchange are subject to governmental control. On November 26 the Bank of Italy's discount rate was raised from 3 to 4 per cent, presumably as a move to protect the gold reserve.

Gold Holdings and Sight Liabilities of Gold Bloc Central Banks

(In millions of units of local currency)

Country	Date	Gold	Notes	Total liab.	Per Cent gold to notes	Per Cent gold to total liab.
France	Nov. 16	82,070	80,193	101,652	102.3	80.7
Belgium	Nov. 8	2,558	3,537	3,741	72.3	68.4
Netherlands	Nov. 13	881	890	1,097	99.0	80.3
Switzerland	Nov. 7	1,908	1,352	2,015	141.1	94.7
Italy	Oct. 31	6,071	13,251	14,388	45.8	42.2
Poland	Oct. 31	497	1,010	1,191	49.2	41.7

Insofar as the countries now on an unrestricted gold basis are concerned, it will be seen that most of them have resources amply sufficient to defend their currencies provided the determination to do so is strong enough. Should these countries permit their currencies to depreciate it clearly would be for reasons other than inadequacy of gold stocks.

Money and Bond Markets

The resumption by the United States of gold imports in substantial quantity, coupled with an abatement of the seasonal increase of the demand for currency, raised member bank reserves to a new high point of $4,196,000,000 on November 21, exceeding for the first time the previous peak reached at the end of August. Excess reserves of New York City banks rose to a new peak of $669,000,000, and those for all member banks also increased sharply, though the total, estimated at $1,950,000,000, remained somewhat lower than at the August maximum, owing to the expansion of deposit liabilities in the meantime.

Reflecting these continued large supplies of funds, money rates have held at the low levels current for some time, namely, call loans 1 per cent, Stock Exchange time money ¾—1 per cent, open market commercial paper ¾—1 per cent for best names, and bankers' acceptances $\frac{3}{16}$ bid—⅛ asked for maturities up to 90 days. The average discount rate on weekly Treasury bill offerings continued under ¼ of 1 per cent for six months dates.

Low Rates Widespread

It is interesting to note how widespread are these conditions of easy money. London banks are paying ½ of 1 per cent on time deposits; discount rates have been lowered from ¾ to $\frac{7}{16}$, and loans to bill brokers from 1 to ½ of 1 per cent. Cheapness of funds is inspiring a boom in British gilt edge securities, and 2½ per cent consols have risen above 90 to the highest point since 1906. This strength in the gilt edge market has encouraged the British Government to call £44,000,000 of 3 per cent bonds for payment next April, evidently in expectation that they can be converted to an even lower interest basis. With a balanced budget, the British Treasury has been carrying through a succession of conversion operations since 1932, in consequence of which nearly £2,700,000,000 of debt has been refunded on a lower yield basis, with annual savings of over £40,000,000 to the British taxpayer.

Paris, Amsterdam and Zurich report a similar monetary case. In Paris, prime bank bills rule ⅞ to 1¼ per cent, depending on names, with the bank deposit rate ½ of 1 per cent on current account, and 1 per cent for 1 to 2 months. Dutch banks are paying ¼ of 1 per cent on current account and ½ of 1 per cent for 1 to 2 months, while Swiss banks are paying nothing on current account and ½ of 1 per cent for 1 to 2 months. The following quotations from the monthly circular of Göteborgs Bank of Stockholm gives an interesting account of recent conditions in the Swedish money market, which we reproduce as being descriptive in a general way of the situation in other markets:

> The accumulation of idle capital has, as is well known, for a long time been characteristic of the situation in the Swedish money market, and in this respect no change has occurred during the period under review. In spite of a considerable rise in industrial production and trade returns demands on the banks have not increased. On the contrary the bank reports show that during the last 12 months the aggregate holdings of Swedish bills of exchange of the commercial banks and the Bank of Sweden have been reduced by 110 mill. Kr. or about 10%. To some degree this development may be connected with reduced stocks, changed modes of payment and quicker circulation of the means of payment and the fact that Swedish industry, which already has carried through certain reconstruction schemes, has as far as possible tried to limit its credit demands for more extensive modernizations and new constructions in view of the uncertain future. The difficulties to find material for investment have exercised a heavy pressure on the interest level, especially of the savings banks, and from different parts of the country is reported a reduction of the rate of interest to 2¾ and 2½%. The fact that a new Government

3½% issue of 70 mill. Kr. was oversubscribed five times in less than half an hour is also characteristic of the situation in the money market.

The large accumulation of idle funds, indicated by the foregoing, is a reflection both of the easy money policies of some countries and of the general inactivity of trade and lack of confidence to which we referred in the preceding article. Under such conditions money tends to remain idle in the banks or to seek the strongest and most liquid investments, driving rates on investments of that class to abnormally low levels.

Bonds Continue Improvement

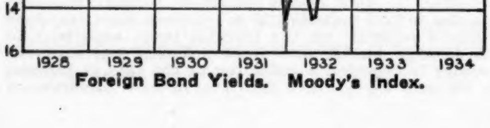
Government and other highest grade bonds continued to display a firmer trend during the month, responding to improved business sentiment, subsidence of inflation fears, and increase of bank reserves. High grade corporation bonds of the Moody AAA class reached new high prices for recent years, and gilt edge municipal and State bonds continued in demand around peak prices. Among the medium and lower grade issues, the industrial group continued strong, while rails and utilities were held back by the uncertain earnings outlook, rumors of railroad reorganizations, and threats of Government financial competition in the utility field.

An interesting development of the month, arising from the cheapness of money, has been the action of some corporations in calling long-term debt for payment out of bank funds obtained at substantially lower rates of interest.

On November 27, the Treasury announced that December 15 financing would be limited to the refunding of $992,000,000 of certificates maturing on that date and, if necessary, the sale of securities for cash to meet current requirements. It was stated that there would be no exchange offering at this time for the $1,869,000,000 of Fourth Liberty 4¼s called for redemption April 15.

Gains in Foreign Bonds

A feature of the bond market during recent months has been the marked improvement that has taken place among foreign dollar issues listed in this market. In general, prices in this group touched their lowest levels around December 1931 and again in June 1932. Over the past two years practically all issues have risen substantially from the extreme lows, and while those in default of interest are still selling at large discounts, others which have come through without cessation of debt service have retraced a major part of the ground lost since 1929. This is shown by the accompanying diagram showing Moody's Index of foreign bond prices expressed in terms of per cent yield. Most of the bonds included in this index have paid interest throughout the depression.



Foreign Bond Yields. Moody's Index.

Foreign bonds have benefited, of course, from the same influences that have helped domestic bonds, to wit, low interest rates and large excess funds. Probably the major factor, however, in their recovery has been the promising signs of economic recovery in many of the countries represented. Evidently there has been a realization on the part of investors that numerous foreign securities were entitled to higher ratings and that sweeping statements as to the "billions of worthless foreign loans" sold in this country were unfair and unjustified.

The improvement in the status of foreign bonds is reflected also in the public offering in this market of $4,195,000,000 Argentine Treasury notes previously held by American banks, and $10,000,000 Republic of Finland serial 4s for conversion purposes. These represent the first public offering of foreign securities other than Canadian in this country in more than four years. In both countries the evidences of economic improvement have been impressive, in addition to which the record of the Argentine Government in maintaining debt service, and of the Government of Finland in making in full all of its payments due on war debts to the Government of the United States, has given these governments a preferred rating in this market.

The Home Building Situation

The action of the Federal Housing Administration on November 1, putting into effect Titles II and III of the National Housing Act, came two months earlier than had been generally expected, and Mr. James A. Moffett, the Administrator, is entitled to credit for the expedition with which the preliminary work was done. This step practically completes the set-up for the operation of the Housing Act, and in the economic situation is a development of two-fold importance. In the first place, the new measures are intended to promote an increase in new home building next Spring, in this respect complementing the operations under Title I, which are already stimulating repair and improvement work in a very substantial volume.

In the second place, under the regulations as announced, changes of a radical and permanent nature in home mortgage practices will be accomplished. It is upon these changes, in fact, that Titles II and III depend for their effectiveness as an agency of business recovery. As Mr. Moffett has said, the program does not rely upon an artificial stimulation of new construction, but upon improvement in the methods of home financing, which are intended to make mortgage loans more secure, and so lead to a revived flow of capital into the residential field. Thus the effects of these Titles, if they work as expected, will long outlast the emergency which inspired them.

Regulations for Mortgage Insurance

The important feature of Title II is the insurance, at face value, of mortgages which qualify by meeting requirements set forth in the regulations. The insurance fund will be accumulated by the payment of premiums by the mortgagor, at the rate of ½ of 1 per cent per annum for new mortgages and 1 per cent for refunding mortgages. The Federal Treasury supplies an initial $10,000,000 to the fund, and will make good any deficit with respect to claims arising prior to July 1, 1937. For the present, only mortgages submitted by chartered institutions (banks, building and loan associations, insurance companies) will be insured, but this provision may be broadened.

With this insurance putting additional security behind mortgages, the regulations lower the return to the lender, and of course, the interest cost to the borrower, accordingly. The maximum interest rate, exclusive of the premium charge, is set at 5½ per cent per annum on refunding mortgages, and at 5 per cent on mortgages to finance sales and new construction. Service charges of ½ of 1 per cent per annum are allowed in specified cases. Recording fees, initial service charges, charge for title search, etc. are as usual borne by the mortgagor, but will be only such as are approved by the Housing Administration.

The rates given are less than those which are customary in many sections of the country. Even so, they do not represent the full extent of the reduction to the borrower. It is provided that the mortgage, while not exceeding $16,000, may be up to 80 per cent of the appraised value, and junior liens are specifically prohibited. This eliminates the expensive second mortgage, which has been the chief factor keeping the costs of financing high, and the greatest saving to the mortgagor will come from this ability to do all his financing on a first lien, at first mortgage rates.

The mortgagee, therefore, under these regulations will not only accept a lower interest return, but will likewise assume the portion of the financing heretofore carried by the second mortgage. The greater risk of lending upon the higher percentage of a property's value, which ordinarily would be compensated by a higher rate, is of course passed on to the insurance fund. As an offset to this risk, it is further provided that—

> The mortgage must contain complete amortization provisions satisfactory to the Administration requiring monthly payments by the mortgagor not in excess of his reasonable ability to pay as determined by the Administration. Such monthly amortization payments must be of such amount that the total principal and interest payments in each month shall be substantially equal.

This provision will operate to reduce the principal of the mortgage perhaps more rapidly than the obsolescence of the property, and to extinguish it entirely in about twenty years. It will raise the payments actually required of the mortgagor to a considerably stiffer figure than is indicated by the interest rate alone; the difference will go to increase the homeowner's equity, being in effect a compulsory saving. This increase in the payments may weaken the effect of the interest cut as an immediate inducement to borrow, and as a stimulus to new building, in view of the difficulty of so many home owners in keeping up even their interest payments. Under more normal conditions it will of course be an attractive feature to lenders, and will tend to stabilize home ownership.

Twenty years is also the maximum maturity permitted, and is expected to be the usual maturity. One of the objects of the Act is to eliminate the short-term mortgage from home financing, in order that concentration of maturities in time of depression, such as has occurred in the past three years, may be avoided.

Interest will be payable monthly. Moreover, the mortgagor is required to make monthly payments to the mortgagee to amortize all taxes, assessments and fire and casualty insurance premiums before their due date. This makes the mortgagee in effect the collector of these sums, and responsible for their payment when due; it goes a long way into home budgeting, in the belief that monthly provision for obligations is likely to work better for the average person than an irregular system. Of course it adds to the cost of servicing the mortgage.

Revolutionary Aspects

The elimination of short term maturities, the provision for amortization, and in particular the prohibition against junior mortgages, are all of revolutionary importance. They are changes which have been urged by many students of home financing methods. The adjustments may be difficult and time-consuming, and the innovations will have to stand the test of experience. They have been received with some criticism as to their effectiveness in the present situation, but from the

broader viewpoint with approval. Not to anticipate the verdict of experience, there are high hopes that the program will place home ownership on a more stable basis than has heretofore been the case. Moreover, the Housing Administration is in a position to take leadership in improving construction and appraisal standards. It will require that the credit standing of the mortgagor be good, and that his obligations be proportioned to his ability to pay.

It should be recognized that without provisions such as these, to set sounder standards of practice, the experiment of insuring the mortgage and of arbitrarily reducing interest rates would rest upon very dubious premises. Interference with a natural interest rate determined by fair competition is as hazardous as any other form of price fixing; and unless the economic principles involved are understood and observed an arbitrary reduction is more likely to harm than help the borrowers, by diminishing the supply of credit offered to them. There is no real evidence that customary mortgage rates have been on the whole disproportionate to the risks and costs involved, although of course there are claims to that effect. In any event there is no assurance that an arbitrary judgment as to rates would be more correct or beneficial in the long run than the combined judgment of borrowers and lenders operating in a free market.

Moreover, it is no final answer to say that the arbitrary rate limitation is justified by the insurance provision, for insurance of itself does not eliminate losses but simply distributes them; and obviously a rate reduction without reduction of losses would simply mean that the difference would have to be made up by someone, i.e., the Federal Government. Also, a system of insurance might even increase losses if it reduced the degree of care exercised by individual lenders. If mortgage insurance should have that effect the end would simply be an underwriting of unsound individual practices by the Federal Treasury, at the expense of all other individuals.

Thus the necessary qualification to make mortgage insurance and enforced interest reductions practicable is that the risks and losses shall be reduced, just as it is necessary to have fire prevention standards, fire fighting organizations, and laws against arson, to make fire insurance practicable. All this means that the standards of mortgage practice established, and the efficiency of their enforcement, constitute the heart of the Housing Act. The hope is that they will supply a sound economic basis for the insurance, make it self-supporting, and thus elevate the whole program from an emergency Federal guarantee, which is its temporary aspect, to a genuine work of reconstruction.

The Possible Market for Housing

There is no question as to the extent of the deferred demand for housing, and the reviving effect upon the general business situation if the obstacles in the way of satisfying this demand could be overcome. It is conceded by all students of the figures that there is an undersupply of housing in the United States in relation to its proper needs, and that the shortage is in quantity as well as quality. In fact, the situation is a literal refutation of the claim that "the country is all built up" and that "there is less work to be done." Aside from the truth that the housing wants of the people may expand as indefinitely as any of their other wants, since most families living in a four room apartment would like to have six rooms if their means permitted, and so up the scale, it is certain that a substantial volume of new construction is needed in some centers if only to accommodate families who are now "doubled up" due to the depression.

The Department of Commerce in the early part of this year made a survey of the housing situation in 64 cities which showed that only 7.8 per cent of the dwelling units were vacant, which is not much over the practical minimum, while 7 per cent of the families were doubled up with other families, and 17.1 per cent of the occupied units were classed as crowded. Moreover, 2.3 per cent of the units were unfit for use, and 15.6 in need of major repairs.

The situation is further illustrated by figures gathered by the Department of Labor from 257 cities. These cities between 1930 and 1933 had an increase in population of about 2,600,000, or 600,000 or more families, but the total residential construction in those years provided for only 150,000, and fire losses and condemnations of course cut into the supply. In these cities the value of the 1933 residential construction was less than 4 per cent of the total in 1925, the peak year.

No improvement of note has been made in 1934. According to the Dodge reports residential contracts awarded in 37 Eastern States in the first ten months totaled $215,000,000. This compares with $204,000,000 in the same period of 1933, $250,000,000 for all of 1933, and $280,000,000 for 1932. By contrast the total in 1928 was $2,800,000,000.

All these facts give evidence of the extent of the need for new housing, to say nothing of better housing. Hardly any other major industry has been reduced to such an extremity of depression, and by reason of its normally great part in the economic activity of the country no other is in a position to contribute as much to reemployment and general recovery if it can be revived.

Importance of Costs

The reasons for the depression of home building are of course involved in the general economic situation as much as in the building industry itself, but undoubtedly the high level of costs is restricting operation. Costs and insecurity of financing, which are the objects of the Housing Administration's attack, are a large element in the situation, but by no means the only one, and if revival will be promoted by reducing one element of costs the principle must apply to all other elements likewise.

General construction costs from 1923 through 1930 were about double the pre-war level, and the net reduction between 1930 and the present time, according to the index published by the Associated General Contractors, has been only 9 per cent. The reduction from 1930 to the low point in April, 1933, was 21 per cent, the greater part of which has been wiped out by an advance since that time.

The Dow Service Building Reports give an index figure for costs of labor and materials used in residences in the New York area which show that a house costing $5,000 for these items before the depression would have cost $3,430 on the average in 1933, and $2,750 at the low point, assuming that labor could then be obtained at less than the union scales. This figure is now back above $4,000, based on the code scales, a drop of say 18 per cent from the peak.

It is pertinent to inquire how many of those who need new or improved housing have had their incomes since 1930 reduced by as little as 9 or 18 per cent, and the answer is self-evident. In short, the question is one of the remuneration of the building trades relative to other occupations. According to the index compiled by the Federal Reserve Bank of New York, wages at the onset of depression were 140 per cent over pre-war, and are now 104 per cent higher. Contractors paid 85 to 90 per cent over the 1914 level for materials, and they are now 76 per cent higher, the rise over the past year having been due chiefly to wage increases. These advances compare with a rise in living costs of 30 per cent, according to the Conference Board's reports. This would represent an impressive improvement in real wages if the building workers were employed, but the unemployment shows that the economic law will not permit them to enjoy it.

As long as building workers demand and receive more than workers of equal energy and skill (and often greater productivity, by reason of machine assistance) in other industries, or on the farm, they will experience less call for their services, and the building industry will be short of work. The interdependence of the economic system is involved.

The maintenance of building costs is the more striking by comparison with the great reduction that has taken place in costs and selling prices in a wide variety of other industries, and the latter have been far more successful in holding their market through the depression. The following table gives prices of certain articles reported by the Bureau of Labor Statistics and by the magazine "Electrical Merchandising," all on the base 1926 = 100, also the 1933 sales in percentage of 1926. Of course the quality of all these articles is immeasurably better than in 1926.

1926 = 100

	Prices March, 1933	Prices Sept., 1934	Sales (units) 1933
Tires	39.7	42.7	76.5
Gas Stoves	67.8	67.3	—
Elec. Washing Machines	38.0	38.2	114.9
Electric Ironers	87.9	87.9	114.0
Electric Refrigerators	61.5*	—	429.4
Oil Burners	59.1*	—	95.1
Electric Lamps	76.5*	—	119.4
Electricity, Dom. Service§	79.7	76.3	175.2
Building	83.1†	92.8† (Aug.)	19.7‡

* Average retail price for 1933 from Electrical Merchandising. Sales figures, except tires, from Electrical Merchandising. † A.G.C. index. ‡ Contracts awarded, dollars, Dodge reports. § Edison Electric Institute, K.W. hours.

It is not contended that exact comparisons can be drawn from this showing, since market conditions were obviously not comparable, many of the items listed being the products of young industries cultivating a new market. Nevertheless, considering the potential market for housing as already described, the general lesson is apparent.

Effects on Present Values

It is claimed by some that reduction of building costs is not desirable, on the ground that the value of existing buildings would be impaired by new construction at lower costs, and that a new deflationary movement would be started which would involve the mortgage structure. There is no reason to accept this as a correct view. In the first place, if values cannot be upheld except by maintaining an artificial scarcity and blocking any increase in activity it would be better both for the business situation and the general welfare to mark them down. In the second place, it is not to be expected that a move which would have such a marked effect in reviving business, increasing employment, and restoring purchasing power would effectively threaten realty values as now established. On the contrary the improved buying power of consumers and the greater demands of business would be more likely to advance values than reduce them. The concept of upholding values by limiting the supply and arbitrarily maintaining costs is an obstacle to progress. Moreover, the economic law will not permit it to work. Such a policy

disrupts the balance in the economic system. blocks the exchange of goods and services, diminishes trade, and leads to all the other familiar consequences which are the true causes of deflation.

Subsidies and Government Aid

Another school of opinion, at the opposite extreme, holds that in view of the obstacles to building recovery it is hopeless to expect private enterprise to make an effective start on it, and that the Federal Government should therefore make vast housing expenditures on its own account. But the Government has no way of building houses more cheaply than private enterprise except through tax exemption and ability to borrow at lower costs. The former is at the expense of the general taxpayer, and the latter establishes an artificial interest rate not truly representing the costs and risks of financing building. If the Government carried on work below its economic cost it would simply be giving a subsidy to the building trades and the favored renters, at the expense of everyone else. It would be introducing a subsidized competition, based upon artificial costs lower than those available to private builders, and likewise leading to artificial rentals. Unquestionably this would disrupt private housing activities beyond repair. If the scheme were on the scale of some of the proposals made, the sums to be raised and the losses to be taken would be so great as to involve the credit of the Government. Finally, nothing would be accomplished toward clearing away the real obstacles in the way of building recovery, and when the sums appropriated were spent the level of costs would be as before, with the industry even farther from a self-supporting basis.

The lending of Government funds at low rates of interest is less objectionable, in degree, than direct grants or Government operations at a loss, but the obstacle of other costs would stand in the way of such a program, and the principle that the stimulus would not be great unless the Treasury's prospective loss was likewise great evidently applies. This country has had experience with tax exemption and other subsidies to promote the construction of low-cost housing, but the results, measured by the number of projects or the employment given, have not been impressive.

There is much interest in the British Government's plan of stimulating housing by loans and direct subsidies, but it is important to consider that in Great Britain costs of housing are not out of line with other costs. According to competent testimony wages of skilled labor in the building trades in England are little higher than wages of skilled workers in other industries and commerce; and costs therefore are in better balance with purchasing power. It is a gross error to assume that the subsidies are wholly or even chiefly the cause of England's housing activity. According to the Economist of November 10,

> During the twelve months ended September 30, 1934, no less than 240,000 houses were constructed by private enterprise without subsidy—an increase of 73,000 as compared with the preceding year. During the same period the number of houses completed with State assistance rose from 50,433 to 51,497.

The article presenting these facts refers also, though not giving figures, to the profits of the building trades, and the fact that this volume of private work can be carried on at a profit is evidence that the cost obstacles existing here have there been overcome.

Services of the Economic System

We gave in our September number a table of index numbers based upon the census reports of manufactures, illustrating the increase of physical production in these industries, in the aggregate and per worker employed, as shown in every census year from 1899 to 1929. This table was computed from tables originally made by Professor Frederick C. Mills, of Columbia University, for the three periods 1899-1914, 1914-23 and 1923-29 and appearing in the volume "Economic Tendencies," prepared by him for the National Bureau of Economic Research, Inc., and published by the Bureau in 1932. Basing his calculations upon the actual production per wage-earner in a large and representative group of manufacturing industries, the statistician has been able to determine the relative volume of physical production per wage-earner in each census year from 1899 to 1929 and to calculate the gains per worker resulting from improvements in methods of production.

We regard this table as so illuminating that we reproduce it here with the addition of another column of index numbers to permit the comparison of changes in the total population of the United States. The census of manufactures was taken every fifth year until 1919 and every second year thereafter:

Productivity of the Manufacturing Industries

Census Year	U. S. Population	Physical Volume of Production	Number of Wage Earners	Output per Wage Earner
	(Index Numbers)			
1899	100	100	100	100
1904	110.4	120.2	108.1	111.2
1909	121.1	154.5	130.0	118.9
1914	130.9	176.8	136.1	129.6
1919	140.3	225.1	169.4	133.0
1921	144.5	186.3	136.2	136.9
1923	148.9	275.6	177.3	155.5
1925	153.4	282.2	169.1	166.9
1927	158.0	287.2	163.6	175.7
1929	162.3	311.4	164.2	189.7

See Tables pp. 26, 192, 290, "Economic Tendencies."

This table makes two showings of great importance, viz: that the number of wage-earners employed in this diversified group of industries

increased at a slightly higher rate than the population of the country (which is an answer to Technocracy and the 30-hour week proposals) and (2) that the productivity per wage-worker nearly doubled in the 30 years, a remarkable record of social progress. Inasmuch as weekly hours were shortened by a tenth to a fifth, it is evident that these gains were accomplished by improvements in organization, methods and equipment. This showing embraces all industries classed in the manufacturing group, including those producing goods for direct consumption and those producing capital goods. Always, of course, the ultimate objective is to serve individual consumption, the distribution between the two classes of products being directed by the law of supply and demand.

The progress of this period gives impressive proof of the service of the economic system to the common welfare. It would be very instructive to have a detailed analysis of it, showing the many changes in industrial processes which have accomplished the result. Such an analysis doubtless would show increasing efficiency in every line of production, resulting primarily from the increasing fund of new knowledge made available by scientific research and secondarily by the unremitting efforts of every line of production to improve its methods and reduce its costs.

Power Production and Transportation

Of especial importance among such improvements are those affecting the basic industries which serve all the other industries and by increasing their own efficiency accomplish general savings upon practically everything entering common consumption. Chief among these basic industries are those producing power, transportation and industrial equipment. As an illustration of such general contributions, Government reports show that no longer ago than 1919 the average consumption of coal by central station power plants in the United States for the generation of electricity was 3.2 lbs. per kilowatt hour, while in 1933 it was only 1.47 lbs. per kilowatt hour, having declined 54 per cent in 15 years. This reduction in the cost of power is to be credited mainly to the builders of power plants, i.e., of boilers, engines and generators, although in part to more scientific selection and handling of coal.

In the year 1922, 163 lbs. of coal were used in the freight service of railroads to each 1,000 tons of freight moved one mile, while in 1933 the amount of coal required for that service was only 121 lbs., representing a saving of 26 per cent. This was accomplished mainly by the locomotive builders and within this period the labor of stoking locomotives has been much reduced by the installation of machine equipment. Obviously the chief economy resulting from gains in locomotive efficiency has been in capacity to draw heavier train loads and make faster time, thus increasing the utilization of both capital investment and operating organization. A great variety of improvements and economies were accomplished in railroad operation during the 30-year period named, and are constantly being accomplished, through the aid of the research work of all the industries whose products either directly or indirectly enter into railroad equipment or service. The roads carried 141 million tons of freight one mile in 1900 with 1,000,000 employes and 448 millions in 1929 with 1,700,000 employes, after a reduction of 17 per cent in working time. Wage rates increased on the average by about 200 per cent. These figures testify not only to increasing efficiency in the railroads but to increasing efficiency in the productive industries which were supplying the products for transportation, and to the increasing supply of goods distributed to consumers.

The new light-weight, fast-running, trains are an important new facility of travel, and accomplish a significant reduction of transportation costs. The introduction of the Diesel engine, burning crude oil, as a rival of the locomotive, is evidence of the inevitable presence of competition in every product and service.

Furthermore, a formidable rival to railroad transportation has been developed, almost wholly since the beginning of the 30-year period named, to-wit, the automotive method of highway transportation. Not many years ago one of the uppermost issues in our political life was over the alleged danger of monopolistic control, not only over transportation but over political affairs, by the railroad corporations, but the economic system within itself has disposed of that issue. Nobody would say that the railroads have a strangle grip on the public today. This fact is pertinent to the rather frequent assertion that little real competition occurs in the economic system.

We have said that the automotive industry has typified industrial development. It has grown within a generation from nothing to be the leading industry in the country, because it offered a product which the public wanted and which has been constantly improved in quality and lowered in price. It put the carriage industry out of business and established itself instead, occupying a very much larger place. One of the largest fortunes ever known in the world has been made in this industry, but that fortune and all of the fortunes made in it represent but a small part of the aggregate sum which the public has voluntarily paid for automotive products and services. Moreover, a large amount of money has been sunk in the industry while contributing to its development, and most of the fortunes that

have been made in the industry are in it yet and in great part receiving very moderate compensation. The same may be generally said of the fortunes made in industry. Thus the Carnegie fortune remained in the steel industry when he parted with ownership, and remains there yet, engaged in the production of steel and retains income-producing capacity only as the public uses its services. The income now goes mainly to Carnegie benefactions.

The Iron and Steel Industry

The iron and steel industry is the producer of the chief material for the tools and machinery of industry, including construction and the facilities of transportation. Fifty years ago a geography in common use in the schools of this country contained a wood engraving of the Victoria Bridge over the St. Lawrence river near Montreal. It was of tubular iron construction and said to be one of the most notable engineering works in the world. It was constructed in the fifties of the last century and in 1898 the superstructure was torn down and a new steel bridge built in its place The first bridge was 16 feet wide, carried one railway track, and had a load capacity of one ton to the foot. The second bridge is 67 feet wide, carries two railway tracks, an electric car line and a wagon way, and has a load capacity of five tons to the foot. The old iron work cost $3,000,000 and the new steel work cost $1,500,000, and between these two bridges the Carnegie fortune and the other large fortunes in steel were made, all comprising but an insignificant part of the values saved and created by the men who by their genius, leadership and capital cheapened the methods of making steel.

The iron and steel industry has expended vast sums since 1898 to obtain economies in production, indeed the works have been almost wholly made over, but the changes have not been of the revolutionary character of the earlier ones and against their influence upon prices have been work-time reductions and rising costs of all kinds, including a 150 per cent rise of wage-rates. Thus the distribution of benefits has gone mainly to the working forces instead of to the consumers of the products. Nevertheless, it is evident that the capital investments have enabled the industry to make the wage-increases without corresponding additions to prices.

Changes in Agricultural Implements

When basic industries are considered, agriculture is usually accorded first place, because food ranks first among the necessaries. According to the Department of Agriculture 100 years ago approximately 75 per cent of the working population of this country was on the farms and was needed there to supply the farm products required, including the small exports of that time. The hours were long with hand tools. With an increasing variety of implements and improvement in their efficiency the farm proportion of all the nation's workers constantly declined until in 1929 it was only 25 per cent of the total. It is said that these changes have been of greater benefit to the consumers of the cities than to the farmers, and in the aggregate of benefits no doubt this is true, but the standard of living for the entire population was raised by the release of labor from the farms to develop the urban industries. In considering any national problem it is necessary to think in terms of the entire national family. In its case, as in the case of a single family, the less time it must give to procuring the mere necessities of life the more time it will have for the pursuit of other ends.

And so, notwithstanding the depressed state of agriculture at this time, which we repeat has been primarily and chiefly caused by the War, it is assuredly true that the development of the implements of agriculture and of the means of transportation across continents and seas, has done more to ameliorate and improve the living conditions of the masses of mankind than all other developments of the time together, because all of the other developments were dependent upon a release of labor from the primary needs.

Refrigeration and Processing Services

Consideration of what the economic system has done for agriculture and through agriculture for the welfare of the consuming millions of mankind, naturally suggests at least a passing reference to the services of the system in such important aspects as the preservation of perishable food products by refrigeration, canning and other methods; the processing services, such as the milling of wheat, the ginning of cotton, the extraction of vegetable oils, the distillation of extracts, the tanning and other treatments of skins and fibers, etc., by which supplies of valuable products are conserved, rescued from waste and prepared for uses formerly unknown.

The diet of the people has been changed, its variety enlarged and the public health promoted by the increased facilities for handling the perishable food products. A comparison of the meat industry now with what it was before the service of scientific refrigeration was available is a notable example. The old-time slaughter houses in the outskirts of cities and towns were tolerated because nobody knew how to dispense with them, but the modern killing and dressing establishment performs these services under sanitary conditions, for a charge that is less than the value of the by-products that formerly went to waste, and a vast system of service from producer to con-

sumer is maintained at a charge so low that the figures although amply authenticated have been commonly regarded as incredible. Thus in the five fiscal years 1929-33 the average combined net results of the four largest meat-packing companies of Chicago, reckoning average profits or losses in cents to each dollar of sales, were as follows: 1929 +1.12 cents, 1930 +0.99 cents, 1931 —0.95 cents, 1932—0.64 cents, 1933 +1.55 cents.

The Panorama of Change

The above comments upon a few of the important industries have been prompted by the purpose to illustrate and emphasize the significance of the table at the beginning of the article. Only a few industries are named, for our space is limited, but if the entire list of industries, professions and skilled services of every kind could be reviewed the same process of unceasing change and development would be found in evidence everywhere. Of other important developments in the same thirty years of which passing mention might be made are those in the generation and delivery of electric current which have accomplished a reduction of about two-thirds in the selling price, the new rubber production in Asia which has reduced the price of that product by more than nine-tenths, discoveries in chemistry which have reduced the price of fertilizer agents and other useful materials, metallurgical discoveries which have reduced the price of all metals, improvements in the cement industry which have increased labor productivity since 1919 by 55 per cent, the new cellulose fibre which has been added to clothing materials in the fabric known as rayon, the introduction of radio transmission and the advance of aviation from a dream to a wonderful system of service. And even so the review is only suggestive.

It is evident that the tendency to progress over the 30 years reviewed is characteristic of the present economic system. It has the persistence and consistency of economic law. That this is so, certainly is a matter of common knowledge, but it can hardly be said that there is common understanding of what it means in terms of the general welfare to have the efficiency of the productive equipment increase as it has done in the last 30, 50 and 100 years. Not many persons adequately appreciate how this progress compares with that of all preceding time, or what it has cost both in the creation of new values and the destruction of old. The later periods have had a valuable inheritance from their predecessors and have builded upon it, but not much industrial equipment that was in use even thirty years ago has any value today.

The Basis of Social Progress

The basis of social progress is ability to produce the various goods and services which are required by an advancing standard of comfort and welfare. The primary source of this ability is in the individual workers of the population, but this native ability has been greatly increased by organization, leadership, scientific research and the instruments, tools, machinery and equipment of all kinds that have been developed to aid the modern industries and professions. The basis of this advance by organization was the division of labor and the resulting exchange of services. It began with the hand trades before historic time and has gone on with increasing specialization to this day. Society advances by the skill and learning of the specialists, the individuals who devote themselves to particular fields of research and effort and whose achievements make up the sum of present knowledge. Their learning is the basis of all of the industries and professional services, and this organization of effort, including scientists, experts, leaders, directors, and managers of business, throughout all ranks to the workers who operate the specialized equipment, is indispensable to the standard of living which the system itself has established.

This organization constitutes the present economic system. In principle and practice it is essentially a cooperative system for supplying common wants. Every specialized group pays for what it receives with its own products or services, the exchanges being accomplished through the bargaining in the markets. The system is a vast net of exchange relations, a mutually supporting system in which each member gains by the skill of all the rest and all attain a higher level of welfare than could be possible without the cooperation.

Prosperity a State of Balanced Relations

Prosperity consists of a state of balanced relations between all parts of the system, enabling the exchanges to be readily made and move into consumption. Inasmuch as all the activities of the system consist of exchanging services it follows that the varied services must be offered in such relations that they will buy and pay for each other. Unless this condition is complied with the system fails of its purpose and falls into disorder, until the unbalanced relations are corrected. Moreover, it is evident that this state of balance or order is the sole condition requisite to full employment, for there is no limit upon the products and services which can be distributed by a harmonious system of exchange.

To sum up: The system of specialized production, which has created the standard of living to which the people of the United States

are accustomed, is a highly efficient system when in order and working harmoniously, but it is an interdependent system, in which every part is dependent upon the other parts, and it is a voluntary system in which every individual or group has a right to bargain over his or its relations with the others. Thus the high efficiency for which the system is prized arises from the very condition which involves the danger of disorder, to-wit, the *independence* and *interdependence* of its constituent parts.

The Real Social Problem

These conditions are unalterably fixed in relation to each other, for individual liberty is fundamental to individual initiative and development, which are in themselves the basis and objective of social progress. Therefore, it is a mistake to assume that all difficulties would disappear if the organization of society were changed. The difficulties are not inherent in the private management or ownership of industry but in the fact that numerous groups of people are exchanging goods and services, and that disagreements and controversies arise in such relations. They arise because the interests seem to be in conflict and if all production was controlled by the Government the problem of determining the relations between the different parts of the system would be the same as now. What should be the relation between the compensation of locomotive engineers and the compensation of farmers, or between the engineers and other branches of railroad services, or between any of the thousands of groups of specialized workers of differing qualifications, training and services who compose the economic system? What reason is there for believing that Government representatives (another group in the system) could adjust the relative values of all products and services to the satisfaction of all concerned? Would the introduction of political authority into these group relations tend to simplify or to complicate them? Would the contesting parties be likely to accept the authority readily or resort to politics to control the authority?

The matter of fundamental importance is the efficiency of the economic system, and what better plan for maintaining a just equilibrium could be devised than that of allowing freedom of movement to and from all groups and parts of the system and for all prices to follow the law of supply and demand?

The present population of the United States or any advanced country cannot maintain the living standard to which it is accustomed, or even the standard of 100 years ago, without organized industry. Organization of any kind implies that the parties joining in the movement have certain purposes in common and are undertaking to work together for their advancement. Successful organization is dependent upon the capacity or willingness of the parties attempting it to understand each other, depend upon each other, overcome their differences and work together for the common ends. Hence the economic problem is a problem of relations, of understanding and of co-operation between the many groups of the economic system, and in a democracy there is no other solution than that which can be reached by the people themselves. The solution is a continuing lesson and experience in social development. It is more than a change of organization: it is the process of civilization. The truth is that a higher order of intelligence and higher sense of social relations are required for membership in the modern economic organization than was required in a primitive society.

The System Based Upon Reciprocity

The only solution of the economic problem lies in an understanding of the simple but absolute truth that every group in the Economic System has more to gain by cooperating to promote the efficiency of the system as a whole than it possibly can gain by efforts to advance its group interests at the expense of the whole. All business is interdependent for the simple reason that in the large sense it consists of exchanging services. Thus it is based upon Reciprocity, and the volume can rise indefinitely so long as the reciprocal relations are maintained, but declines inevitably when no longer reciprocal. The highest conceivable state of prosperity would mean that the system was working in such nicely balanced relations that every worker was employed and all of the products were moving rapidly into consumption. The community would then be getting out of the system all that it had the capacity to give at the time. No group in the system can get more for itself by strife or the exercise of power than it will receive under such a state of harmonious relations, for if it shall be successful in raising its nominal compensation above the reciprocal relation with other groups it will lessen their power to buy of itself and lose more by the shrinking volume of business (and unemployment) than it gains by the imagined advantage. Pertinent to this statement is a discussion of building costs in a preceding article in this issue, entitled The Home Building Situation.

It is a fundamental principle of social science that the individual shall seek to advance his own interests only as they are in harmony with the interests of the social body, and this is the basis of all legitimate business. The farmer as a member of the economic system produces a crop mainly for the purchasing power which it will give him and his family in the markets, while the goods they purchase have been produced for a similar purpose, and

thus the system functions in compliance with the principle stated. The great variety of offerings in the markets affords an incentive to every member of the system to produce something that will have selling value (and purchasing power) in the markets and the success of such individual efforts is dependent upon their response to the wants made known in the markets.

The fundamentally cooperative purpose of the economic organization, viewed as a whole, is a basis for good understanding between its parts, and for mutual efforts to harmonize the activities and increase the efficiency and stability of the system. Although much emphasis is placed upon the evils of competition, the dominant purpose is cooperation. It is important to understand that the competition which is incidental to the improvement of useful services is necessary to all progress and is never demoralizing, because it creates new purchasing power. All of the disorders and abuses that are charged to the economic system result from disorganization and unbalanced relations, and invariably arise from abnormal conditions originating outside of the normal processes of the system itself. The popular hallucination that the war "prosperity" was real and enduring has taken new form in the blind assumption that the depression is chargeable to the economic system instead of to the World War, the most stupendous interference with economic relations that ever has occurred. The normal activities of the economic system make for order and tend to unify society, but the free economic system is composed of human beings and is subject to their somewhat limited capacity for cooperation, evident on all sides.

On the other hand, the conception of the system as composed of groups and classes whose interests are inherently conflicting, inevitably makes for antagonisms and strife, and is destructive of cooperation. Its influence tends to disintegrate society and nullify the process of specialization and integration by which all of the progress of the past has been made. It fails to recognize the fundamental truth that all of the gains of the highly organized modern system are dependent upon harmonious relations between the parts. It is impossible to disregard this requirement of the system and still realize the benefits which the system affords.

This affirmation has a concrete meaning: Prosperity cannot be restored by attempts to build up the industries independently and seriatim, without regard to their relations to each other. The true test of any policy proposed for the benefit of a part is to be found in its effect upon the unified system. The parts can benefit only by the prosperity of the whole and prosperity for the whole means benefits for every part. The conditions of health in the human body furnish a perfect analogy for the conditions of prosperity in the economic system.

The Profits of the System

Criticism of the economic system is mainly directed at the profits. Profit is a form of compensation and under all codes of law and morals genuine services are entitled to appropriate compensation. The public determines comparative compensation through its own buying in the markets, and the varying rates constitute the scale of inducements by which enterprise, capital and labor are guided and the economic system is automatically governed when left to itself.

In closing this article upon the services of the economic system it seems appropriate to refer briefly to the figures given in these pages last month of the profits of all manufacturing corporations in the 14 years 1919-32, as reported by the Treasury. The net profit calculated upon aggregate gross business was 3.62 per cent, which means that on the average over the 14 years, of each $1.00 received by these companies for their services they paid out for materials, labor and other costs $0.9638, and had left as compensation $0.0362. Further light is thrown upon the allegations of monopolistic control by the showing that 22 per cent of the aggregate product of these industries was produced by companies operating at a loss, which is significant of the struggle for survival. And lastly, these figures take on additional interest when given in connection with the showing of the table at the head of this article, that the increasing efficiency of these industries in the 30-year period 1899-29, resulted in an increase in the average production per worker employed of 89.7 per cent in the last year of that period over the first year, a total which yields a simple average of approximately 3.0 per cent per year or a rate of 2.2 per cent compounded. In the 10 years from 1919 to 1929 both profits and efficiency gains were higher, the former at the yearly average rate of 4.23 per cent and the latter at the simple rate of 4.26 per cent, or 3.61 per cent compounded. Thus the consuming public gained approximately as much by the increasing efficiency of the industries as the industries obtained in profits. This showing does not leave much of the theory that the benefits of industrial progress are absorbed by the owners of the industrial properties, or of the twin fallacy that failure to distribute such benefits brought on the depression.

End.

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